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CreditSights welcomes the opportunity to comment to H.R. 2990, "The Credit Rating Agency Duopoly Relief Act of 2005." HR 2990 marks the first real action plan we have seen to inject some competition into a sector that has badly needed some innovation and some new market entrants for some time. As such, we fully support the legislation and expect that it will serve as a catalyst for constructive change in the credit ratings industry by promoting competition and bringing more intellectual and financial capital to the space. The legislation will serve the interests of the market by eliminating a major regulatory deterrent that has discouraged market entrants and investors.

As a growing provider of various credit research and analytical services selling to many of the same customers that use credit ratings services, CreditSights has in the past had the opportunity to provide input into the review of the NRSRO framework. While critical of how the agencies have performed and used their special rights and privileges as an NRSRO, we still endorsed the concept of the NRSRO in our March 20, 2002 testimony before the Senate and again as part of the SEC Hearing on the Ratings Agencies on November 15, 2002. Our endorsement of the NRSRO concept in those hearings was more a reflection of the critical role that such ratings providers play in the capital markets, and the need for a regulatory "bar" to clear for such agencies given their extremely important function. In endorsing the NRSRO concept, we had also clearly stated that the agencies were in need of some increased regulatory oversight that the current system did not provide. Both aspects of our view reflected their role in the markets. Our support of HR 2990 is consistent with our earlier testimony on NRSROs.

HR 2990 provides an elegant solution to the stalemate that has come out of almost four years of debate by offering to immediately lower barriers with a variation of the NRSRO concept with its approach of using the "R" as a "registration" system. In earlier testimony, we also noted that we had never applied for NRSRO status and had no plans to do so any time soon. From the standpoint of CreditSights, the cost and effort involved was not worth it for our firm given the track record of companies seeking to enter the NRSRO space. HR 2990 is likely to encourage more companies to enter into the fray of building larger scale ratings organizations.

Our own experience is not atypical for growing credit research firms as we look to gain a foothold in the independent credit research space. While we do compete with some of the NRSROs in providing alphanumeric ratings through our statistical default risk model, our main business line is not "ratings." That was as much a necessity to achieve growth as it was a strategic need since the current system frustrates expansion in the ratings business. Our main business line will remain providing information-intensive credit research, data products and default risk models more consistent with that of a registered investment advisor. We only provide "ratings services" as defined in HR 2990 through our statistical product offerings. We also compete in a limited context with Moody's and S&P in nonratings areas, where we see both rating agencies continuing to expand.

We have watched with increasing interest that Moody's and S&P have both expanded in what we would traditionally view as the capital markets debt research business and which in our view historically would clearly fall under either SEC or NASD regulation. We do not view regulation under either framework as particularly onerous and in fact just a normal cost and basic

responsibility of doing business. Unlike the rating agencies, our employees have grown up in regulatory environments at their prior employers (NASD, FSA, SEC), and CreditSights in its current form now falls under the regulatory purview of the SEC and FSA. That fact has never encumbered our independence, our ability to exercise our First Amendment rights, or constrained our ability to apply a range of methodologies in our research.

For any start-up, offering ratings products is a daunting challenge given the natural commercial barriers piled on top of the artificial barriers. We thus have focused our business-building efforts on research services provided to institutional investors, banks, and intermediaries since the barriers to the NRSRO status were absolutely insurmountable for any start-up. The only way to build any meaningful, independent research effort was to focus on "high information content" products and go to the key users of the such information—namely, the institutional investor base that uses these services and not the issuers that have become the regulatory captives of Moody's and S&P. We have built our base of clients to over 600 major institutional investors, but still view the enormous market power of the rating agencies with some trepidation given their inherent advantages to package services with their ratings offerings and use their considerable NRSRO-based market power to expand their client base in non-ratings services. Opening up avenues for more non-NRSROs to compete across a more diversified set of product offerings—including ratings—is consistent with opening up the market to competition in coming years.

HR 2990 Will Foster Competition and Let the Market Decide

If enacted, HR 2990 could change the competitive balance for many growing firms as well as provide the impetus for expansion strategies by leading providers of financial media and data-based products. We do not see HR 2990 as in any way "disruptive" to the capital markets. It may in fact be disruptive to the concentrated market power and entrenched position of Moody's and S&P if major content aggregators use the opening to roll up more of the small and midsized companies to take on the global scale of the duopolists in this high margin and growing business line. Users of credit ratings services will not be unduly burdened by changing the meaning of the "R" in NRSRO ("R" would now stand for registered). Much of the debate will not even show up on their radar screens, so it is hardly a major disruption. For investors, there may be some routine adjustments to make in language in prospectuses and regulated enterprises might have some paperwork to do, but they always have routine adjustments in keeping their primary constituencies (shareholders, policyholders, etc.) informed.

Anointing more ratings agencies with the "revised" NRSRO status will just follow a path already well blazed by the major debt underwriters for decades. Basically, once there were fewer. Now there are more. Educated players in the market can choose who they will deal with. As a frame of reference, the rise of the commercial banks and non-US banks in underwriting debt has not threatened the market. It has provided choice for consumers, brought innovation, and injected more financial and human resources. It had also heightened competition, raised the costs of personnel, pressured pricing, and tightened margins. New market entrants in the NRSRO space will raise more capital to expand, more professionals will seek employment, and larger entities will "buy" and "build" their way in. In fact, there will be job creation and human resource migration from other disciplines that may be shrinking (commercial banking, sell-side research, etc.). The issuers and the investor base will have more options and pricing will come under pressure and growth will need to be shared. That is the crux of the matter for Moody's and S&P. In the end, once Moody's and S&P get past this debate and the changes are enacted, they will just go back to making massive amounts of money and profitably growing their businesses.

As somewhat of a parallel example, we would remind the Committee how vigorously the securities industry opposed the entry of the commercial banks into their underwriting businesses. The reasons to keep the banks out were well documented and well lobbied. We would point out now how many of the same executives from the securities industry later were happy to go work for the commercial and non-US banks that ended up entering the brokerage business (usually for considerably more pay) after the banks entered the space and subsequently prospered. In the end, there was considerable innovation that came with the new competition, greater liquidity in

the marketplace, a wave of new product introductions, and strengthening of the US financial system. Along the way came wave after wave of rated products that enriched Moody's and S&P, who faced no such competition and pressure to innovate. We would expect a similar dynamic to be seen in the NRSRO space if competition is allowed and barriers to entry come down. There will be capital inflows, mergers, migration of hungrier personnel from the incumbents looking to take leadership roles, and more competition. There will be movement of experienced personnel from the Street as the more entrepreneurial-minded look to help growing firms eat into the NRSRO franchise and take equity in growing enterprises. Basically, all the competitive instincts that make the US the leading market in financial services are there to be tapped, and the NRSRO incumbents are looking to keep those instincts at bay.

In our earlier endorsement of some form of NRSRO framework, we nonetheless had highlighted that the approach to anointing new NRSROs was inefficient and no longer reflected the needs of a rapidly evolving marketplace where the lines between "ratings," "research services," and "data and analytics" products were all blurring and doing so across a global marketplace. We would highlight that Moody's and S&P have certainly taken full advantage of that blurring to rapidly expand the array of information and data services they provide. They of course have expanded into new areas from the protected beachhead of an anachronistic, ill-defined regulatory framework that gives them inherent advantages against any competitor that would look to offer service in competition with these two financial Goliaths. We also noted that the lack of competition and the limitations of the issuer-based model were undermining the quality of the products and services delivered into the market by making the revenue stream more tied to regulatory fiat than consumer (and investor) choice.

The rules (or lack of rules) as they are currently in place also have failed to police conflicts of interests that could be inherent in offering an array of non-ratings services to entities that the agencies also rate. The market has been down that path before with the audit and consulting functions of the relatively more regulated accounting firms, but it is an issue that has never generated much interest on the regulatory front in the context of the NRSROs. While we do not expect those issues of conflicts to be ever be formally regulated, we would expect that competition will be fostered by allowing market players in the area of general capital markets research or data services to enter the credit ratings space—just as Moody's and S&P enter these other areas more aggressively. Healthy competition and entrepreneurial innovation will only benefit from leveling this playing field.

Market Conditions Are Ripe for New Market Entrants

It is a fact of life that the incumbent rating agencies have created a de facto duopoly over the past three decades despite the combination of all the second tier ratings players into #3 Fitch. That market reality is not going to change unless the barriers are lowered soon. In fact, even more damage will be done and the natural commercial barriers will be raised even higher the longer the current artificial constraints are kept in place. There are sweeping changes that have been taking place the last several years that are creating exciting new market opportunities for entrepreneurial start-ups, for financial media firms, for providers of data and analytics, and for providers of private equity capital. These changes are partially rooted in advances in technology and low cost delivery of content via the internet, but the changes are even more tied to the dynamics of the post-Enron, post-WorldCom market backdrop and how that has altered the risk-reward for the banks and securities firms that were the traditional providers of institutional debt research.

In terms of the expansion of new markets, the increased use of securitization, the evolution of the Basel regulatory framework, the development of more regional capital markets in both developed and emerging markets, the steady growth of issuers and continued disintermediation of the commercial banks, and the rise of the credit derivatives markets all create opportunities for new products, more volume, and more expansion. The incumbent NRSROs would obviously prefer to carve those opportunities up among themselves. We don't blame them. Those opportunities will attract new capital and market entrants if the barriers are lowered. Letting the entrenched have

too much of an influence in shaping the lowering of barriers is questionable, since they will push for delay and higher barriers.

The market backdrop is creating both risks and opportunities for the market. The risk is that the breadth and volume of credit research is suffering on Wall Street after the "Enron and WorldCom years," and the opportunity is that the trend has provided room for new businesses to be created that offer research and information services that are independent and unbundled from "the Street." Traditional providers of market-based credit research services were usually housed at the investment banks, commercial banks, and brokerage houses, but we have seen a clear retrenchment of research services based on concerns over conflicts of interest, liability, and cost. The largest commercial bank and one of the largest bulge bracket debt firms in fact recently made the decision to stop publishing corporate bond research, and that has been mirrored in part at other major banks and brokerage houses both in the U.S and the EU. It is no coincidence that both Moody's and S&P are expanding in capital markets research areas and serving that same client base, and that in many respects they see it as a logical extension of the ratings services they have provided. They are standing on the line of being in the "buy-sell-or-hold" debt research business typical of an investment advisor without (yet) quite crossing it.

The same "walking the line" approach has always been true of the ratings services they have provided, where they stood on the line of being an integral part of the underwriting process of Wall Street while representing themselves to be mere publishing operations. The NRSROs are in substance in a role that is an extension of the underwriting business while exempt from expert liability under the 1933 Act and all the while waving the First Amendment flag. It is a masterful stroke of genius and brings high margins and low contingent liability risks, but it is one that has outlived credibility. While everyone else that comes close to those same lines is subject to regulation by any combination of the NASD, SEC, or FSA among others, Moody's and S&P would like to skate by as the New York Times and Wall Street Journal of credit quality. HR 2990 will allow more companies to enter the space who will see their role exactly for what it is. They will be providers of market-based research very much akin to what the sell side has been providing for years and subject to regulation. We expect the regulation to be very light-handed compared to anything the typical Wall Street analyst is routinely accustomed to.

Below we look at some of the questions that seem to be recurring in the debate around HR 2990. From our standpoint, the questions come down to support of competition or just more of the same delays. HR 2990 is a great start in allowing some real action to take place and a lot less dialogue that always ends in the same place, with the NRSROs and some of their allies frustrating change and thwarting competition even as they speak of how they welcome more market entrants.

Does HR 2990 promote competition?
Yes. It is clear that streamlining the process for the entry of new, credible and viable providers of credit ratings services will attract new ratings organizations from the current population of competitors both in the US markets as well as from Europe and the Asia-Pacific who are looking to establish a global footprint to rate issuers across multiple currencies. The much-discussed chicken-and-egg debate around "nationally recognized" should be put to a market test and move beyond the batteries of lawyers and interest groups that continue to weigh in. There is nothing more consistent with the principle of free, competitive markets than lowering barriers and allowing for new market entrants to bring innovative, high quality products to potential customers. Issuers will have more choices as will investors and consumers of credit risk assessment products and services. In the end, the regulators should let the market decide. If a major institutional investor writes a check to a research company or rating agency, and then keeps renewing, that ratings provider and research service should be deemed credible. Backroom negotiating, expensive lawyers, and good lobbyists should not be the swing factor.

Does HR 2990 protect investor interests in still holding NRSROs up to a set of standards?
Yes. We do not see S&P and Moody's as disagreeing that the historical NRSRO designation underscores that their role was a very important one, and some function was to be played by the

regulators in setting a bar for providers of ratings services to protect the safety and soundness of markets. The fact that their status was derived from a no-action letter and essentially constituted "zero regulation" apart from the benefits of special status (including exemption from liability and exemption from Reg FD) only made their regulatory deal even sweeter—and more profitable. HR 2990's "registration" system still provides a special status in many regards. The main challenge for aspiring ratings firms does not change. They still need to have institutional investors and/or issuers accept them and in many cases include their specific firm names in investment parameters. That is no small challenge and will only be possible if they bring more to the table in terms of product, information value, experience, and client service.

Is the time opportune for immediate movement given developments in the markets?
Yes. We suspect that the duopolists would like to hold onto their three-decade NRSRO head start a bit longer, and for Moody's its century of brand-building would seem like it does not need much more of a structural advantage provided by the regulators. Moody's and S&P certainly see what others are seeing in the market, namely, that the market has never been so ripe for rapid change in terms of how research and data services are delivered and that there are revenue opportunities in all of this change. Credit ratings services will be swept up in that pace of change also, but it is the new growth markets in research services and data and in rapidly growing markets that will compound the revenue growth above and beyond the usual expansion being witnessed on traditional ratings products. Profit and growth attracts competition, but for reasons now all too well known the NRSRO sector has not seen much competition.

Will the three-year rule limit the growth of new NRSROs and limit the growth of independent credit research?
No. The distinction between ratings services and nonrating services and how that flows into the registration process is an aspect of the bill that could use some clarification, but the bill refers to companies whose primary business is "ratings." It does not call for raising the barriers for new research firms, but calls for opening up the NRSRO playing field. The 3-year time constraint is understandable, but we would also point out that many companies could be potentially credible and significant players in the ratings market where "ratings services" have not been either their primary source of business for three years or where they could offer a viable product in 1 or 2 years.

We also would recommend caution around the timeline game played by the incumbent NRSROs. A classic ploy of the incumbent rating agencies is to request that the firms show they have a lengthy track record in default histories. In other words, the angle is "wait 10 or 20 years" before they can enter. We would highlight that many firms bring myriad skills to the table in various aspects of risk (estimating loss exposure on assets, assessing structural risks, specialized industry expertise that can be used in assessing issuer risks, security-specific knowledge such as with asset backed securities, regulatory expertise, accounting knowledge, etc.) which all play a role in how consumers of ratings and research products use ratings services. To use a sports metaphor, *default* is the ultimate risk and constitutes the "goal line" in credit research. That said, much of the action takes place between the 20-yard lines. For investors, securities price volatility and rapid changes in credit risk—though short of default—can be the more frequent risk variable that impacts performance and portfolio risk management.

We have some other concerns about the 3-year rule. The development of a less concentrated credit ratings market needs capital and global reach to make a significant impact against the market concentration of Moody's and S&P, and the mix of boutiques and modestly sized operators below the three leading NRSROs will need to experience a mix of M&A-driven expansion and possibly strategic and financial partners to reach the requisite scale. The three-year rule presumably will not interfere with that process and we also assume the SEC will have the latitude to use discretion in registering companies that may "buy" into the space rather than build. In one fell swoop one of the large financial media companies could make a meaningful dent in this business. It is unclear how that 3-year rule flows into any such inroads as part of diversification move by any such large well-capitalized players unless they acquire companies

meeting the criteria. We would note that all of the incumbent NRSROs are busy buying up "content" assets outside the traditional ratings services areas. Other major players operating in those areas should be afforded the same opportunity with respect to the ratings business. It would only serve the interests of building competition.

In addition, one of the objections to the bill from one trade group included the concern that providers of more traditional credit research ("buy, sell, hold") and investment recommendations would need to seek registration under the new act. While this is an issue worth clarification and could have an impact on CreditSights as a provider of such research, we currently view ourselves as registered investment adviser regulated by the SEC in the US and by the FSA in the U.K. We are accustomed to regulation in the securities markets and credit markets in particular. In fact, we have always been more surprised at how little regulation such major market forces as the NRSROs are actually subjected to. We see the SEC as playing a role that encourages the development of independent research platforms as well as more competition in the NRSRO sector and we expect more supportive than intrusive behavior on their part. Certainly the findings from the SEC hearings on NRSROs appeared to approach the topic in that fashion. In the end, debt research has not been an area very high on the SEC's priority list and one which traditionally had been an NASD issue. That will change as the market evolves and more research is unbundled from the street.

Will an activist role by the SEC discourage new market entrants into the ratings process and extend to general providers of credit research services?
It should not be the case. The SEC has done extensive work in the areas through its NRSRO review and can clearly determine the distinction between a provider of ratings services and a provider of independent research under its registered investment advisor framework. At the very least, HR 2990 relieves the SEC of the 4-year wrestling match it has been in as to whether it should take on the costly and time-consuming challenge of developing a rigid set of criteria that would determine the next round of NRSROs. The delay had been perplexing, but not for those who watched the incumbent NRSROs trying to frustrate and delay that process the way they are looking to derail HR 2990. In the end, the SEC asked for Congressional authority. They may not have expected HR 2990, but now they can take prompt action once it is passed. In a booming securities market, time is money for the NRSROs. The more time it takes for change and reform, the more money they make. All the while, they keep on pushing into more nonratings businesses.

Will HR 2990 be a catalyst for the building of viable competitors?
Yes. One of the major risk factors for any start-up, any strategic operating company, or any financial buyer looking to expand in this growing sector is the significant regulatory uncertainty that the jaded history of the NRSRO process has to inspire. To the extent that the bill lowers the level of confusion in the market, we will see more investment capital flowing into the sector, more strategic acquirers of assets entering the space as expansion moves or as part of an extension of existing business lines (media, data, analytics, etc.). We will also see more cross-border M&A activity by non-US firms, and the growth of bond markets where banks traditionally dominated will fuel interest in the business. For example, Japan, India and China have all witnessed a mix of mature players and start-ups expanding in the ratings business.

There is every reason to expect a lot of interest in entering the credit ratings market. According to Economics 101, high profits, high margins, high growth, and high prices in an industry attract market entrants. The fact that there have been virtually no meaningful market entrants—and in fact a considerable level of consolidation among the NRSRO incumbents and aspiring ratings firms, has all been well covered in prior hearings in Congress as well as at the SEC. The performance of the lead players certainly should attract attention. The financial performance of Moody's as the one NRSRO pure play in the market has been nothing short of extraordinary. Since mid-1998, when what later became Moody's was split off to trade largely on its own fundamentals, the total return on Moody's stock has been 427% vs. only 25% for the S&P 500 and 54% for the S&P 500 Financial Index. McGraw Hill (S&P's parent company) has returned 195% over that same time span. McGraw-Hill's lucrative financial business is housed within a

more mature and lower margin pool of other businesses, so it underperformed Moody's but still crushed the overall market.

Since the March 2002 Senate Hearings and the start of what has been a multi-year review by Congress, the SEC, and various agencies and political entities around the world, Moody's has returned 209% and McGraw Hill 70% vs. 18% for the S&P 500 and 30% for the S&P 500 Financial Index. It is safe to say that the fear of impending regulatory doom has not discouraged the market view of Moody's or S&P's risks. To break it down into time segments, Moody's stock has returned considerably more after the "threat" of regulation in the post-Enron/post-WorldCom environment than before. That is simply because the opportunities in the market have never been greater, global growth in a range of security classes has never been so attractive, and Moody's and S&P can still execute on global expansion in new regions, new products, and new non-ratings services from the staging platform of protected NRSROs. That protected status raises risks for potential market entrants including well-capitalized content aggregators that could be looking for horizontal expansion opportunities. It is hard enough competing against entrenched financial behemoths with inherent commercial advantages (client base, brand power, enormous financial flexibility) without keeping the behemoths on regulatory steroids.

The success of Moody's and McGraw-Hill against this backdrop is hardly a major surprise. The growth prospects for them remain compelling, and they have been able to counter and stall the lowering of barriers with considerable skill. What is most stunning is that such a favorable backdrop has not brought more concerted attempts to enter the space. That is something for the Committee to ponder as they look to institute reform. The lack of new NRSROs has to be clearly laid at the feet of the traditional regulatory framework, and there needs to be rapid change if the policy goal is to promote competition and rid the market of entrenched barriers. The four years since Enron have blown by rather quickly, and there have been a lot of hearings and a lot of testimony filed here and filed there. Some action is long overdue to get the real process of fostering competition on track and out of the discussion stages. The regulatory regime itself can be evolutionary just like virtually all other regulation, and the regulatory fear-mongering by the rating agencies is starting to get very repetitive.

Does HR 2990 constitute intrusive, "Big Government" regulation?
No. Anti-regulation sentiment is hardly new, but the benefits to the market that accrue from intensified competition are also hardly new. To espouse competition while at the same being against regulation is also not unusual, but the incumbent NRSROs have a unique twist. After all, it is regulation that has created the virtually insurmountable barriers they benefit from and impaired competition. HR 2990 corrects that flaw without getting intrusive.

The tone of the criticism of HR 2990 from various quarters is somewhat inconsistent on the "intrusive" theme. It seems to take on the combined attack of the bill doing too much but also too little. HR 2990 is called intrusive by the rating agencies themselves, but the bill is also accused of leaving too many questions unanswered. It appears to be the "you hit him high and I will hit him low" approach to attacking a bill. The bill itself is brief and is a call for simple action to open up the playing field. That is hardly intrusive. New ratings firms that register and cannot build a client base will quickly become "registered non-factors." The bill does leave unanswered questions, but the SEC is charged with continuing the process of sorting out the key variables as they follow up on their earlier work. To the extent HR 2990 made any such attempt to address all the possible questions in a legislative package, then it would in fact be intrusive and overbearing micromanagement of the free market. HR 2990 is not intrusive at all, and rather light in terms of the regulatory framework compared to what the traditional providers of credit research—the securities firms and banks—routinely face as part of the underwriting and trading process.

It is unlikely that any single legislative or regulatory initiative will come close to perfectly addressing all the needs of the credit markets and consumers of risk ratings products, and the market certainly can deal with evolutionary, light-handed regulation. What most segments of the "financial research" markets are not accustomed to is no regulation at all. Zero regulation (apart

from the huge benefits they are provided by the existing framework) appears to be the clear goal of Moody's and S&P in the areas of ratings services.

Practitioners of widely disseminated credit research in the securities markets are usually under the NASD or FSA framework, which is quite extensive but has never encroached on their ability to freely voice their views. Buy-side credit analysts seldom publish opinions for external dissemination, but they also are governed by a wide range of regulatory constraints tied to the type of portfolios they service from insurance to pension to mutual funds. Somehow the market is expected to believe that the NRSROs—one of the most powerful constituencies in the money market, debt and equity-linked capital markets and increasingly in the bank debt markets—should escape all regulatory oversight in stark contrast to the well traveled path of regulatory evolution we have seen in the brokerage, banking, and asset management industries. We can appreciate their attempt for what it is, but it is time for responsible governing bodies to take some action. HR 2990 is a great start.

Will HR 2990 help address the quality vs. quantity debate?
Yes. The quality vs. quantity decision is one best left to the marketplace and HR 2990 is firmly in that camp. If a company does not have a viable product, customers will not pay for it, investors will not listen to it, a revenue stream will not be generated, and that ratings or research service will not be a factor. Such offerings will be relegated to being just a voice (however loud) on the periphery of the market. We would assume the lack of a client base would lead to the provider not even being designated under the NRSRO system HR 2990 proposes. The track record requirements and proof of demand would seem to be a low hurdle to clear for a high quality product. If investor and intermediaries pay a company for its product, then that would appear to pass the quality requirement in the eyes of the market. Once again, let the market decide.

The market is quite capable of selecting across competing services. Just as investors can select their brokerage houses and underwriters they choose to do business with, why would investors not be afforded the same opportunity in providers of ratings and research services? We do not see any agency or legislative body better able to make the selection process transparent than investors parting with their hard-earned cash to pay for a service. Freedom of choice also promotes a focus on quality and innovation. That is hardly news, but it just has not been applied to NRSROs. Institutional investors have ample incentive to be cautious in their selection process. After all, they face myriad regulations and laws which govern the behavior of investors and underwriters around prudent investment practices, fiduciary responsibilities, or proper due diligence. These will more than provide additional safeguards around the market selection of "quality" providers. The market may even benefit from *both* quality and quantity. That will lower costs and improve the standards and quality of information flowing into the market.

How can rating agency services be distinguished from other services?
We would highlight that the array of services that the rating agencies provide multiplies each passing year as they venture out from behind the protected enclave of their NSRSO status. They have expanded their array of data products, analytics offerings, default risk models, expanded in various areas of what can be defined as "capital markets research," launched a range of modular risk management products for counterparty risk, expanded and/or entered equity research, offered customized consulting services, and continue to ride the wave of unprecedented expansion in the global capital markets. Sometimes the growth of these other services is overlooked in the NRSRO debate.

Based on past history, it is not a surprise that Moody's and S&P will look to derail reform that streamlines entry into their businesses. After all, they use their protected status to get into everyone else's. We have always found it striking that a major rating agency can be meeting with an issuer that it rates while at one end of the hall it is offering a package of risk management services and at the other end of the hall be offering data products. It is a compelling sales pitch when there are already well-established sales channels. In effect, the NRSROs often find themselves in a position where are offering to sell an expanded array of services to a major

issuer where the NRSRO can have a major influence on that potential customer's cost of funding, opine on that potential customer's claims-paying ability, rate their mutual funds, score their counterparty risk, or evaluate their corporate governance. It starts to take on the appearance of the "offer you can't refuse." That type of market clout is rare and would appear to demand some regulatory framework—almost by definition.

Is this debate about First Amendment rights?
No. While some of the incumbent NRSROs have sought to use that ploy, we do not see how HR 2990 denies an independent voice the right to be anything other than just that in the market, i.e. independent. HR 2990 is in fact more about the market hearing even more independent voices. If there is anything in the spirit of the First Amendment, it is just that. One does not even have to be a seasoned skeptic to see this maneuver for what it is. The debate is not about the First Amendment; it is about the next dollar and who gets that dollar…and the dollar after that.

The desire to be classified as a publishing company more akin to the Wall Street Journal or Washington Post than a securities research firm has always dominated the legal strategy of the rating agencies. It might be an easier case to make if all large issuers of bonds were forced to pay millions of dollars a year to the New York Times to access the market, and buyers of those bonds, asset backed securities, and loans needed to pay tens and hundreds of thousands to Business Week to get the information required to remain in compliance with their investment parameters. The newspaper industry probably would not mind having Moody's and S&P's protected status, high profit margins, pricing power, and guaranteed volume.

In the end, this debate is about commerce and oversight of a major part of the underwriting chain and asset management business. While we would not begrudge anyone a shot at a last-ditch attempt to head off progress that might impinge on their margins, we are not aware how the increased array of independent research voices in the debt and equity markets have been encumbered from making their views clear whether it be under SEC or the even the NASD regulatory frameworks. We suspect that there are some companies out there who would like a little less free speech. They may not be happy with HR 2990 for promoting more of it. As it stands now, Moody's and S&P seem to be saying "Congress shall make no law respecting an establishment of competition to the NRSROs."

Will HR 2990 preclude a range of methodologies and impair information flows?
We are trying to see a scenario where the SEC takes the approach of micromanaging the methodologies of the rating agencies. The SEC is resource-constrained and is generally not staffed by Commissioners or professionals with extensive experience in the credit markets and the underwriting business for corporates, munis, structured securities, etc. On the other hand, they certainly are aware of what constitutes sound policies and procedures around conflicts of interest. HR 2990 inherently promotes a range of methodologies by promoting new entrants and also by including statistical models in the NRSRO picture. We see the "lack of diversity" argument against HR 2990 as more than laughable, especially since it has come from those firms that have been hindering diversity and competition for years. The fact that they often mimic each other in their ratings and methodologies should not be extrapolated to new entrants.

We also do not see why the SEC would look to be the arbiter of methodologies and ratings criteria. For example, it is hard to see where the SEC is going to tell an industry analyst at a rating agency he may be reviewing that the SEC is challenging him on his recovery rate assumptions for an oil company or call another analyst on his overemphasis on earnings volatility in his view of metals industry operating risk. If a rating agency *upgrades* only companies with rising leverage and declining earnings and vice versa on downgrades, even then the SEC might also not chime in. They will not have to. That NRSRO will have no customers.